Hawaiian Electric Company, Inc. • PO Box 2750 • Honolulu, HI 96840-0001

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PUBLIC UTILITIES COMMISSION

Darcy L. Endo-Omoto
Vice President
Government & Community Affairs

July 17, 2009

The Honorable Chairman and Members of
the Hawaii Public Utilities Commission
465 South King Street, First Floor
Kekuanao'a Building
Honolulu, Hawaii 96813

Subject: Docket No. 2008-0083 – Hawaiian Electric 2009 TY Rate Case
Comments on the Consumer Advocate's July 15, 2009 Letter

Dear Commissioners:

To facilitate the Commission's review of Hawaiian Electric Company, Inc.'s ("Hawaiian Electric" or "Company") July 8, 2009 response to the *Interim Decision and Order* ("ID&O") issued on July 2, 2009 in this proceeding ("July 8 Response"), this letter will explain why Hawaiian Electric retained in the 2009 test year certain remaining costs identified in the Division of Consumer Advocacy's ("Consumer Advocate") July 15, 2009 comments.

In its July 15, 2009 comments on Hawaiian Electric's July 8 Response, the Consumer Advocate stated that it reviewed the Company's filing and concluded that Hawaiian Electric's proposed adjustments were conservatively prepared, that the Company's revised schedules are in general compliance with the Commission's ID&O and that it does not have any objections to Hawaiian Electric's filing. Hawaiian Electric is pleased with that finding and appreciates the Consumer Advocate's expeditious review of the Company's filing.

The Consumer Advocate also stated that the intent of the ID&O may be subject to interpretation and provided an Attachment 1 ("Consumer Advocate's Attachment 1") that identified costs that might be characterized as HCEI-related (i.e., non-labor expenses) that remained in the 2009 test year after the settlement between the parties in this proceeding. Attachment 1 categorized the remaining costs into three categories: 1) costs for obtaining approval, 2) consulting and outside services, and 3) lease costs. The Consumer Advocate stated that it was not certain whether the Commission meant to exclude only incremental HCEI costs from the amount of interim relief or intended the exclusion of all costs related to programs or initiatives associated with the Energy Agreement.

Hawaiian Electric's July 8 Response made a number of adjustments as directed by the ID&O, resulting in a decrease of $18.7 million to the 2009 interim increase amount of $79,811,000 in the Company's Statement of Probable Entitlement.[1]

With respect to the remaining costs in the Consumer Advocate's Attachment 1, Hawaiian Electric retained those costs in the 2009 test year revenue requirement for the reasons explained below.

HCEI-Related Outside Services Costs

Section II.1. of the ID&O specified three types of HCEI-related items that would be excluded from interim rate relief: a) sales decoupling, b) HCEI-related positions, c) HCE-related outside services. The remaining items specified in the Consumer Advocate's Attachment 1 are not associated with sales decoupling or HCEI-related positions. With the exception of the Tower Gateway Base Station lease expenses (which are included in research and development expenses), they consist of non-labor outside services expenses. Section II.1.(c) of the ID&O, which addresses HCEI-related outside services, states the following:

> The Parties described $2,220,000 of Big Wind implementation studies on page 21 of the Settlement Agreement. In settlement discussions, the Parties agreed that HECO recover these costs through the REIP Surcharge. The Parties propose that if HECO does not recover these costs through the REIP Surcharge, it should be allowed to recover them through rates approved in this rate case. These studies, however, relate to an HCEI project not yet approved by the commission. In addition, the commission has not rendered a decision in the REIP docket, Docket No. 2007-0416. As such, the commission does not at this time approve these costs for recovery through interim rates or a surcharge mechanism.

From the wording in this provision of the ID&O, it was clear to the Company that "these costs" referred to the $2,220,000 of Big Wind implementation studies costs. As the Company explained in its July 8 Response, it had already removed $2,220,000 of Big Wind implementation studies costs (and $200,000 of PV Host Program outside consulting costs) from the revenue requirement in its Statement of Probable Entitlement. Since the ID&O did not identify any other HCEI-related outside services costs to be removed from the 2009 test year, the Company made no further adjustments in this area.

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[1] As the Company explained in its 2009 test year rate case filings, the activities specified in Attachment 1 are necessary to achieve State of Hawaii objectives to integrate substantial amounts of renewable energy into Hawaiian Electric's grid. In order for the Company to pursue these activities in the time frames desired by the State, the Company would need to receive timely recovery of the associated costs. Therefore, the Company's retention of certain costs in the test year was based on whether there were possibilities to recover the costs through another mechanism, e.g., the Renewable Energy Infrastructure Program ("REIP")/Clean Energy Infrastructure ("CEI") Surcharge.

> The ID&O also allowed certain costs related to participation in Energy Agreement-related proceedings to be included in the 2009 test year. Footnote 16 of the ID&O stated the following: On page 21 of the Settlement Agreement, the Parties agreed to normalize outside services' costs related to participation in commission-initiated proceedings or obtaining commission approval (e.g., legal and regulatory support services) for initiatives identified in the Energy Agreement...
>
> The commission will allow HECO, for interim purposes, to include legal and regulatory costs related to the PVHost, AMI, and the FIT programs, as described above."

In accordance with footnote 16 of the ID&O, the Company retained in the 2009 test year the "Costs for Obtaining Approval" in column H of the Consumer Advocate's Attachment 1. The Company also included research and development ("R&D") expenses for activities that were initiated prior to the Hawaii Clean Energy Initiative.

<u>Research and Development Costs</u>

The Biofuel Agriculture Crop Research and Advanced Metering Infrastructure ("AMI") research and development ("R&D") (which includes the lease of Tower Gateway Basestations) costs identified in the Consumer Advocate's Attachment 1 are all R&D expenses for activities that were initiated in or before 2007, well before the announcement of the Hawaii Clean Energy Initiatives in January 2008, or the execution of the Energy Agreement in October 2008. That is why the Parties in this proceeding agreed that these items could be included in the Statement of Probable Entitlement. For example, R&D costs for all of these items were included in the <u>2007</u> test year expenses as follows:

1. HECO's updated test year estimate of Non-EPRI R&D expenses in the miscellaneous A&G account for the 2007 test year included anticipated R&D costs for the AMI project, biofuel crop studies and the development of an environmental strategy for biofuel feedstock. The AMI project was discussed in Bruce Tamashiro's testimony (T-13), in the Company's responses to CA-IR-182, 452, 456 and 471, and in the Company's August 2007 Supplement (HECO T-13, Attachment 1). These items (at settlement amounts) were all included in the final settlement. Stipulated Settlement Letter (September 5, 2007), Docket No. 2006-0386, at pages 16-18 and HECO T-13, Attachment 2.

2. The test year expenses for Production O&M included R&D expenses for earlier phases of biofuels testing.

   The 2007 estimate included an amount of $100,000 to be used for initiatives related to biomass energy or biofuels. All funds for the biofuels initiative will be directed towards biodiesel testing in HECO steam boilers on Oahu. As stated in the response to HECO–IR-407, HECO was developing a test plan for biodiesel testing in a steam boiler, schedule and budget. (The test plan includes selection of one of four Combustion Engineering steam boilers on the HECO system based on space availability for biodiesel fuel storage and delivery, infrastructure availability (pump size and pressure rating, etc.), minimum modifications, timing of next planned maintenance outage.) After these items were firmed, HECO indicated that it would enter an agreement with EPRI (to leverage EPRI funds). See HECO's response to CA-IR-407 in Docket No. 2006-0386.

Since the submittal of the response to CA-IR-407, HECO developed a draft statement of work for the EPRI agreement. (See Attachment 5(J) to the response to CA-IR-407 for a copy of the draft statement of work). The major tasks are:

Task 1 – Fuel Compatibility Evaluation--fuel property and viscosity analyses will be conducted to evaluate the compatibility of biodiesel/LSFO blends with existing fuel delivery and handling systems at the host site. Fuel analyses and viscosity-temperature tests of neat LSFO, neat biodiesel, and a series of biodiesel-LSFO blends (e.g., possible range of 5% to 90% biodiesel) will be conducted to characterize fuel properties and flow behaviors (i.e., viscosity vs. temperature). Data from these tests will help formulate the co-firing test plans, including the identification of test limitations and potential equipment modification requirements.

Task 2 – Biodiesel Co-firing Test Plan--developing a test plan for co-firing biodiesel with LSFO in a boiler. Information from Task 1 will be used to identify required equipment modifications and support development of the test matrix. The test plan will identify the fuel blends and volume requirements, fuel delivery/mixing procedures, co-firing system design, boiler operating test points, performance and emissions data, testing protocol and instrumentation, and data reduction methodologies. Environmental issues and permit requirements will also be assessed. The envisioned testing may include, but not be limited to, measurements of combustion stability, flame stability, boiler performance, fuel system performance, and emissions (e.g., O_2, NO_x, CO, CO_2, SO_2, PM-10, and opacity).

Task 3 – Procurement and Installation--includes the procurement of biodiesel fuel, and procurement and installation of fuel system equipment, boiler-related components, sensor and emissions analyzers, and data acquisition system. Information from the test plan developed in Task 2 will be used to guide the procurement and installation tasks.

Task 4 – Shakedown and Testing--equipment and subsystems shakedown will occur. Successful shakedown operations will be followed by co-firing testing and data collection per the test plan developed in Task 2.

Task 5 – Test Data Reduction and Analysis--includes the analysis of collected data, formulation of conclusions, and preparation of the final report on co-firing tests.

This is a multiyear project where activities and expenses will occur in 2007 and 2008. The steam boiler testing is projected to take place in mid-2008 subject to internal and external approvals.

A Supplemental Project Agreement for this project was signed by HECO and EPRI on August 8, 2007. The total project funding provided in the Agreement is $500,000, consisting of $200,000 in 2007 and $300,000 in 2008. Under the terms of the Agreement, HECO will be invoiced $100,000 in 2007, and $150,000 in 2008. See Attachment 5(K) to this Response for a copy of the executed EPRI Agreement. Now that the Agreement has been signed, EPRI will invoice HECO for $100,000 co-funding, and HECO will pay the invoice before the end of 2007.

The total budget for this project covering 2007 and 2008 activities is estimated at $500,000. By signing this Agreement, HECO will obtain $250,000 in EPRI funds--$100,000 in 2007 and $150,000 in 2008.

This project is in line with state policies favoring the development and use of biofuels. Act 159, passed by the 2007 Hawaii State Legislature, has the stated purpose to encourage further production and use of biofuels in Hawaii, establishes that biofuel processing facilities in Hawaii are a permitted use in designated agricultural districts and establishes a program with the Hawaii Department of Agriculture to encourage the production in Hawaii of energy feedstock (i.e., raw materials for biofuels). Act 159, signed June 8, 2007; effective July 1, 2007. The 2007 Hawaii State Legislature also passed a measure which requires Hawaii Department of Business, Economic Development, and Tourism to develop and prepare a bioenergy master plan that sets the course for the coordination and implementation of policies and procedures to develop a bioenergy industry in Hawaii. The primary objective of the bioenergy master plan shall develop a Hawaii renewable biofuels program to manage the State's transition to energy self-sufficiency based in part on biofuels for power generation and transportation. Act 253, signed June 5, 2007; effective July 1, 2007.

See HECO T-6, Attachment 5, August 2007 Supplement, Docket No. 2006-0386. This item was included in the final settlement. Stipulated Settlement Letter (September 5, 2007), Docket No. 2006-0386, at pages 6-7. The biofuels testing by HECO also was identified as an action item in various IRP plans.

REIP Framework

None of the costs included in the test year R&D expenses are proposed to be recovered through the proposed REIP/CEI Surcharge. First, Hawaiian Electric's AMI application in Docket No. 2008-0303 seeks recovery of AMI project implementation costs through the surcharge, not R&D costs. In addition, Section III.B.1.b. of the proposed REIP Framework, which the parties in Docket No. 2007-0416 agreed should be approved, states that the electric utilities would not seek to recover the costs of central station generation-related assets or similar utility renewable energy generation assets through the REIP Surcharge. The concept underlying the REIP Framework was for the Company to facilitate integration of third-party renewable energy into the Company's grid (Reply Statement of Position, Docket No. 2007-0416, Exhibit B, page 5). Since biofuels would be used for the Company's generating units and the Biofuel Co-Firing Project included capital assets to be installed at the Kahe 3 generating unit, the Company did not intend to propose recovery of the biofuel-related outside services costs through the REIP/CEI Surcharge. Therefore, the Company would have to recover those costs through the rate case.

Sincerely,

Darcy L. Endo-Omoto
Vice President
Government & Community Affairs

cc: Division of Consumer Advocacy
Department of Defense